Calm after the storm

Xavier Nicholas examines the draft legislation released on 11 December 2012

Budget 2012 and moral repugnance

The Chancellor's description in his Budget 2012 speech of aggressive tax avoidance as 'morally repugnant' set the tone for the announcement of a general anti-abuse rule (GAAR) and a package of measures designed to pull the plug on the use of 'envelopes' to hold UK residential property. The consultation paper released in May confirmed what became known as the 'three pronged attack':

- A new stamp duty land tax (SDLT) rate of 15% on the purchase of UK residential property for over £2m by non-natural persons (NNPs), effective from 21 March 2012.
- An annual charge, now known as the annual residential property tax (ARPT), on properties valued at over £2m owned by NNPs, effective from 1 April 2013.
- The extension of capital gains tax (CGT) to non-UK resident NNPs on disposals of UK residential properties, effective from 6 April 2013.

The definition of NNPs for SDLT and ARPT purposes was to include companies, collective investment schemes (CIS), and partnerships in which a company or CIS is a partner. For CGT purposes, the definition was also to include trusts.

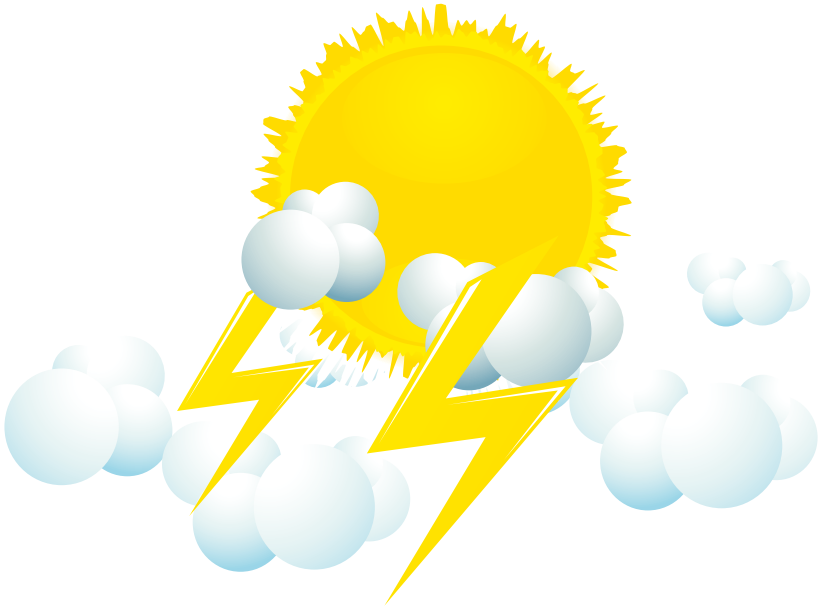
Consultation and confusion

While the SDLT changes were announced as a done deal (or so it seemed), the ARPT and CGT proposals were subject to a period of consultation.

KEY POINTS

11 December 2012:

- Confirmation of the annual charge and extension of capital gains tax to residential properties worth over £2m owned by non-natural persons
- Significant exemptions for trusts, property developers and investors, public houses and farms take the sting out of the original proposals
- A tough message for owner occupiers means restructuring before April 2013 remains necessary in some cases



PROFILE

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Profile Xavier Nicholas is a solicitor in the private client group of Forsters LLP. His principal area of work comprises tax, trust and estate planning advice for UK and overseas individuals and trustees, with an emphasis on advising non-UK domiciled clients and work which has an international dimension. He has a particular interest in structuring the ownership of UK residential and commercial property for development or investment.

Lobbying followed. Concerns were raised about the effects on the London property market, the City, and the wider economy. Objections were made that the extent of SDLT avoidance had been misunderstood and over-stated, the use of envelopes having been driven by inheritance tax planning and asset protection, and SDLT having more often than not been paid on the purchase by the envelope. The absence of rebasing provisions from the proposed CGT charge was criticised as retrospective. Fears were expressed that taxpayers could be penalised for de-enveloping, as a result of tax liabilities triggered when dismantling structures.

Professional advisors, meanwhile, were busy deciding what to advise their clients. To much frustration, the best advice has been to wait and see. The release of the draft legislation, then, was nervously anticipated.

Legislation and enlightenment

Many will be pleased to discover that the draft legislation contains not only significant revisions to the ARPT proposals, but also unexpected amendments to the SDLT changes implemented in March. Unfortunately, the CGT legislation will not be published until January 2013 (and the SDLT changes will not be effective until Finance Bill 2013 receives Royal Assent, probably in June or July 2013).

The full picture, therefore, remains to be seen and in some cases a further wait may be necessary before decisions can be made. The following is a summary of the highlights so far.

Trusts awarded 'natural person' status

The draft legislation seeks to align the SDLT and ARPT rules, and indications are that the CGT provisions will follow suit as far as possible. The proposal to treat trusts as NNPs for CGT purposes has been dropped, so a common definition of NNP will apply to all three taxes. This is a welcome simplification and should preserve the scope for planning involving direct trust ownership in appropriate cases (although the resulting IHT exposure will still need to be managed).

Open for business: exemptions from the new rules

In response partly to concerns about the impact of the new rules on inward investment, another welcome change is an exemption from the 15% SDLT rate (in favour of the standard 7% rate), ARPT and CGT, for properties held by NNPs for the following business purposes:

- redevelopment and resale in the course of a property development trade;
- resale in the course of a property trading business;
- rental investment;
- employee accommodation (but only for employees with less than a 5% stake in the business);
- occupation by farmworkers for the purposes of a commercial farming business;
- enjoyment by the general public on a commercial basis for at least 28 days a year; or
- charity.

The business use exemption must be claimed within 30 days of purchase and then annually by 30 April each year (although the first claim is due by 1 October 2013). Changes of use part-way through a year must be reported within 90 days.

An exemption from the 15% SDLT rate for property developers with a two-year history had already been included as part of the SDLT reforms in March and the consultation promised a similar exclusion for the ARPT. The removal of the two-year requirement and the widening of the exemption to include rental investment and other business uses, will be warmly received. Developers should be reminded that the exemption from CGT does not necessarily mean exemption from tax: development profits are likely to be subject to either corporation tax or income tax.

No place like home: a message for owner occupiers

The business use exemptions contain traps for the unwary. In particular, the exemptions for property development, trading and investment will be disapplied if a property is occupied by a non-qualifying person (and, importantly, even if that person occupies on commercial terms). The definition of a 'non-qualifying person' is extremely wide. It includes an individual who owns a company (or who is the settlor of a trust which owns a company), the individual's spouse, his relatives and the spouses of those relatives.

Exemption from the 15% SDLT rate is similarly conditional on the property qualifying for the business use exemption and not being occupied by a non-qualifying person for three years following the purchase (with a claw-back charge where these conditions are breached). One might expect restrictions along the same lines to be included in the CGT legislation.

Property valuation and the ARPT

The ARPT rates remain unchanged:

Property value	ARPT
£2m or less	No charge
£2m – £5m	£15,000
£5m – £10m	£35,000
£10m – £20m	£70,000
Over £20m	£140,000

The bands will be fixed going forward, but ARPT will be linked to the consumer price index. Properties will be valued on purchase and on five-yearly valuation dates beginning on 1 April 2012, with a pre-valuation checking service for properties within 10% of a threshold. Where a property qualifies for exemption from ARPT for part of a year only, the charge will be pro-rated.

Walking the capital gains tax cliff edge

Where the business use exemption does not apply, any gain on the disposal by a NNP of a property for over £2m will be charged at the higher rate of CGT (28%). In response to comments that the £2m 'cliff edge' could create distortions in the market (by creating an incentive to under-sell a property in order to avoid tax), a tapering relief will apply to reduce the effective rate on sales for just over £2m.

Rebasing conceded

The accusation of retrospective taxation has been acknowledged. On the disposal of a property by a NNP for over £2m (and if the business exemption does not apply), only the gain attributable to the period since 6 April 2013 will be subject to CGT.

UK resident companies next in line?

The Government is considering whether to extend the CGT charge to UK-resident companies, which would lead to an increase over the corporation tax rates that currently apply.

The view from abroad: a sigh of relief

The revised proposals will be met with a sigh of relief by non-residents and non-domiciliaries in particular. The business use exemption is a substantial concession and means that genuine non-owner-occupiers should not be affected by the new rules. Many well-advised UK residents will have avoided company ownership for their family homes due to existing anti-avoidance rules. Where these structures exist, both residents and non-residents should consider restructuring before April 2013. Care will be essential to avoid inadvertent CGT and SDLT charges on transfers of ownership.

So far as new purchases are concerned, for many investors the new rules will mean a return to business as usual. Non-resident companies (combined with non-resident trusts where appropriate) will continue to appeal as mechanisms which, depending on the circumstances, can be used as a shelter against inheritance tax, to mitigate income tax, and defer or avoid CGT. As before, scrupulous implementation and management will be essential to the successful navigation of anti-avoidance rules. On-going monitoring will become even more important from April 2013 as non-business use, even for a short period, could give rise to tax liabilities. To complicate things further, the impact of the GAAR will also soon require consideration.

The coalition conundrum

The recent speculation and uncertainty were no doubt partly fuelled by the fact that the consultation document released in May asked as many questions (19 in total) as it answered. The impression was not of a particularly sure-footed proposal, nor one that was released with complete conviction. It might be suggested that while the coalition government felt the need to be seen to be tough on tax avoidance, particularly in view of press attention at Budget time, the PR objective was achieved when the initial announcements were made. Subsequent amendments are more likely to fall beneath the radar of casual observers and are perhaps more readily conceded as a result.

While it would be excessive to describe the most recent announcements as a U-turn, the revisions have taken much of the force out of the original proposals. The three prongs have not quite fallen off, but they are certainly less sharp than they were.